PRICE ONE PENNY

Imports and Employment

An Economic Note

BY

The Right Hon. RUSSELL REA

CASSELL AND COMPANY, LTD.
London, New York, Toronto and Melbourne
1910

Imports and Employment

An Economic Note

BY

The Right Hon. RUSSELL REA

Published by CASSELL & COMPANY, LTD.,
La Belle Sauvage, Ludgate Hill, London, E.C.,
FOR THE
COBDEN CLUB, Caxton House, Westminster, S.W.
1910

Imports and Employment

An Economic Note

Two points of economic interest have emerged during the Tariff Reform controversy of the last seven years. First, the actual incidence of an import duty; and, second, the effect of foreign imports on home employment. This note is concerned with the second. Outside the scope of these two questions, which lie at the root of the argument so far as it has been pursued in a scientific spirit, the controversy has been quite legitimately conducted on practical, inductive, statistical lines, and these have almost exclusively engaged the attention of politicians on both sides. They have bandied isolated and often unrelated statistics to prove either the progress and prosperity, or the decline of this country, or the greater progress or the greater poverty of, say, Germany. Though useful and necessary, the latter class of arguments are essentially inconclusive, for they cannot take into account all the circumstances other than tariffs which may have contributed to the results achieved, and too often they have been like sword strokes in the air which have failed to meet the blows of the adversary. At the base lie the two economic questions I have mentioned, and when these are answered and understood, the statistics showing the evolution of international trade and the variation of prices will be seen to fit the scientific theory.

The first question—the actual incidence of an import duty—has attracted the attention of our most skilled economists, and Free Traders may be well contented

with the conclusions arrived at of the infinitesimal amount of any possible contribution by the foreigner towards any taxes on food imported into this country. To the man in the street the daily market prices are sufficient proof that under Protection his "food will cost him more."

But the second question, of the effect of foreign imports, especially of manufactured goods, on employment, is one more difficult to explain to the average citizen voter. As his natural first impression in the one case is that an import tax will add just so much to the cost, and he wants some reasons for changing his first opinion, so in the other case his natural first impression is that if we import a foreign article which we can make ourselves it must deprive the men who could have made it of their employment, and he will want good reasons for changing this impression.

In the former case the burden of proof is thrown on the Protectionist; in the latter it is thrown on the Free Trader.

I will attempt to put the Free Trade case as simply as it is capable of being presented, and to show that foreign imports do not reduce home employment and cannot do so.

The General Principle of Foreign Trade.

(1) *As stated by Free Traders.*

One general principle, one economic dogma, may be assumed. It has become the common property of the economist, the street-corner orator, and the leaflet-monger on both sides. This is that foreign commerce *is* exchange, that imports must be paid for by exports, and that exports must be paid for by imports or not at all. Free Traders from the beginning have asserted that this dogma is the conclusion of the whole matter, and the destruction of

the whole case of the Protectionists, namely, that foreign imports diminish employment.

(2) *As stated by Protectionists in reply.*

Those Protectionists who attempt any scientific justification for their creed deny that this is the conclusion of the whole matter; they admit freely that this truth is axiomatic, but they carry the analysis of it a stage further. Here, it is they who are at the disadvantage of having to present their reply in a form which is not easy of apprehension by the careless man in the street; but they have succeeded in making their case fairly familiar to their propagandists, and circulating it in their leaflets. It is undeniable, they admit, that exports and imports of merchandise, of specie, and of services, when properly calculated, must balance, and that, if they do not, the difference represents an international removal of capital; they will admit that every import creates a demand which must be satisfied by an export, but that, they say, does not dispose of the case that the importation of foreign articles we are able to make for ourselves does in fact reduce employment at home. A British railway company, for example, may purchase a locomotive in Belgium for £2,700 rather than give £3,000 to a Glasgow firm, and this may be paid for by the exportation of 10,000 pairs of Northampton boots of the value of £2,700 to a Brussels "emporium." It is true that the purchase of the foreign locomotive has indirectly given employment to a set of Northampton bootmakers in the place of that of which it has deprived the Glasgow engineering firm, but it is none the less true that it has deprived this country of the whole sum of the employment it has given to the Belgian firm, for, had the order been sent to Glasgow, the men thereby employed would have purchased the boots or other equivalent British goods. They admit that both our

foreign exports and imports would be diminished, but the exchange would nevertheless have occurred, with this difference, that both transactions would have taken place in this country.

The Protectionist's statement of the case has been thus summarised by one of our ablest economic controversialists: "In the one case the Belgian engine exchanges against the boots; in the other case the Glasgow engine exchanges against the boots (or their equivalent in other goods). If the engine is bought in Belgium, the boots made at Northampton will go to Belgium, and no boots will go to Glasgow; but if the engine is made at Glasgow the boots made at Northampton will go to Glasgow and no boots will go to Belgium." Two British capitals and two sets of men would have been employed instead of one. Two profits and two employments would have remained in this country instead of only one. So that, although the railway company saved £300 by sending their order to a foreign country, this country lost in rent, profit and labour, not £300, but £2,700. Thus, say the Protectionists, we see that, in matters of trade, private individual interest is often opposed to the general interest, and the State is justified in regulating international trade by tariffs designed to protect our home industries.*

(3) *The Free Trader's rejoinder.*

Is there any reply to this case? The reply appears to be complete, but it requires a somewhat deeper analysis

* In a passage which has lately been much quoted from Adam Smith's chapter on the Employment of Capitals, the Protectionists seem to themselves to have discovered a great authority for this view. In the two short paragraphs he devotes to the subject he did not stop to analyse fully the instances he gave. He assumes two capitals and two effective demands, one in Scotland and one in London. If the merchants in both places had traded with Portugal instead of with each other, the effect on employment would have been the same. In this and the following passage Adam Smith appears to lend his countenance to the idea that one capital may "replace" two equal capitals. It clearly can do nothing of the kind at the same time, and the context shows he meant successively and not simultaneously. It is these successive replacements of capitals by exchange this note is an attempt to examine.

of the various reactions of the case I have put as an illustration, and it is as much more difficult to present in a popular form than the Protectionist's case I have just given, as this, in its turn, was more difficult to explain than the simple axiom of the Free Trader to which it was supposed to be a reply.

The Absurdity to which the Protectionist Argument Leads.

First consider the case from the point of view of Belgium. The owner of the Brussels "emporium" purchased £2,700 worth of British boots for the same reasons which induced the British railway company to buy the Belgian engine—because he wanted them, because he had the money to pay for them, and because he could not get boots of equal quality in his own country for less than £3,000. The Belgian Protectionist might say as justly as our own that the transaction had deprived the Belgian bootmakers and the country as a whole of employment, for although the Belgian engineers would have missed their British order, yet the Belgian bootmakers who would have been employed in executing the Brussels order, instead of the Northampton bootmakers, would have exchanged these boots, if not for an engine, certainly for equivalent products of Belgian industry.

We see, therefore, that the Protectionist argument lands us in this absurdity, that each country has equally lost employment by the exchange of its commodities, although no one would maintain that there has been a loss to both countries taken together, or that there would have been a loss if both Belgium and England had formed one country; just as no one would maintain there would have been a loss of employment if the railway company had given their order to a Manchester firm at £2,700

instead of to the Glasgow firm at £3,000. The absurdity into which the Protectionist's argument has led him is patent.

Where, then, is the fallacy?

The Fallacy.

A double fallacy is involved in the Protectionist's statement.

Fallacy No. 1 lies in applying the terms and the law which govern foreign trade to domestic trade, to which they do not apply.

The Protectionist has failed to appreciate the full meaning and the limits of the axiom to which both sides in this argument have assented—that *in international trade* imports must be paid for by exports; how this principle differentiates foreign trade from home trade; and in what manner it applies to the one and not to the other.

The government, the coinage, the national taxation, especially the banking system, constitute this country in its strict geographical sense an economic unit. We are surrounded by a financial frontier; our exchanges with foreigners are not unimpeded, everything has to pass a toll bar, and pay or receive as the case may be, the current rate of exchange. We know the effect of alterations in the rate of foreign exchanges on the movements of gold, and on the consequent movements of prices; and we know that the total effect is to constitute this country, in its strict geographic sense, an economic unit to which our axiom of the equation of exports and imports applies, as it does not apply to separate parts within it.

But within the limits of this country there is no such law, there is no such equilibrium, there is no necessity for regulating the internal geographical movements of the precious metals, there is no financial apparatus for so regulating them. All trade, internal as well as external,

is doubtless exchange, and it may be said that every economic unit, whether it be the family or the firm, or even a collection of similar units, such as the agricultural community as opposed to the manufacturing community, must roughly preserve this equilibrium of exchange. Their exports of services and goods must balance their imports and consumption of goods and services, and so far as they fail to preserve this equilibrium there must be a transference of capital from one unit or group of units to another.

But within the geographical limits of this Kingdom these exchanges and these transfers of capital are unregulated, unimpeded, and continuous. They are not subject to the financial apparatus, or even to the economic influences which govern foreign trade. All business is free and fluid. The liquid capital of the country which is engaged in commerce is practically in one stock. No man can point out his own share of it at any moment. It perhaps consists of an entry in a bank-book or other paper instrument giving him a certain general command over the wealth of the country. There is no automatic adjustment of internal transactions. There is no economic law which decrees that if Northampton buy from Glasgow, then Glasgow shall buy from Northampton and from nowhere else.

It is precisely this *difference* between internal and foreign commerce which provides the whole argument commonly used for proving that in *foreign* commerce exports must balance imports, and that every import creates an export. Doubtless, as I have already said, all commerce, internal and external, is exchange. If London gives an order for a locomotive to Glasgow, there is a fair exchange of a locomotive for a paper instrument, which is in effect a general title to a certain amount of the diffused wealth of the country. If London gives an order for a

*

locomotive to Belgium, payment is made in a similar manner by a paper instrument. But there is this vital difference between the two cases. In the latter, unless that paper instrument is bought back by the export of some British product, it must be followed by the export of 2,700 golden sovereigns. And this necessity creates the economic conditions which make it profitable for a Belgian capitalist—that of the owner of the Brussels "emporium"—to sell this paper instrument back to us by giving an order for 10,000 pairs of boots *we should not otherwise have had.* It is this necessity which is the entire basis of the theory of foreign trade, that imports must be paid for by exports.

In the former case no such necessity arises. A transfer of the amount involved is made in the respective bank-book of the two firms parties to the transaction, which is adjusted at the clearing house, *and the transaction is ended.*

Thus we see that though every commercial transaction involves an exchange of two capitals, a transaction with a foreign country involves two such exchanges of two capitals, a domestic transaction only one. The difference between giving an order abroad and giving it at home is that the former entails, by the operation of economic law, an equivalent and complementary reciprocal transaction; and the latter does not entail, and, as a matter of fact, is not followed by any such complementary and reciprocal transaction.

Now apply this principle to the summary of the Protectionist's case I have previously quoted, and the fallacy in it will become apparent. The writer says, "In the one case the Belgian engine exchanges against the boots, in the other case the Glasgow engine exchanges against the boots (or their equivalent in other goods). If (1) the engine is bought in Belgium, the boots made in Northamp-

ton will go to Belgium, and no boots will go to Glasgow. If (2) the engine is made in Glasgow, the boots made at Northampton will go to Glasgow, and no boots will go to Belgium." In this statement, that part I have marked (1) is correct—if the engine is made in Belgium, certainly, by our hypothesis, boots will be made in Northampton which would not otherwise be made in England, to exchange for it. The part I have marked (2) is correct so far as it says that if the engine is made in Glasgow no boots will go to Belgium, but incorrect in interposing the statement that "the boots made in Northampton will go to Glasgow." I ask what boots? The boots for the Brussels "emporium" are now made in Belgium, and there are no other boots or any other goods of exchange concerned in the transaction. To secure an order from Glasgow for Northampton for boots the Protectionist has tacitly and unconsciously assumed the existence of an "emporium" in Glasgow as well as in Brussels demanding boots, and having a capital to pay for them. If such a buyer exist, Northampton will probably secure his order, and should the engine be ordered in Belgium, it will secure the Brussels order as well. Thus, though Glasgow would in the latter case have missed the order for the engine, Northampton would have got two orders for boots instead of one. This is the exact parallel of what does happen in the case of exchange with Belgium.

The correct statement of the transaction is this: If (1) the engine is bought in Belgium, boots will be made in Northampton and will go to Belgium, and no boots will go to Glasgow; but if (2) the engine is made in Glasgow, no boots or other goods of exchange (as any co-relative of this transaction) will be made at Northampton or elsewhere in England, either for Glasgow or Belgium.

We see that every domestic exchange implies two capitals to be exchanged, and two active and effective de-

mands each for the particular form of capital of the other. The railway company wanted an engine for its money, the Glasgow engineers wanted money for its engine. If the transaction takes place, the railway company gets the engine, and the Glasgow firm gets the money, and it is ended.

In a foreign transaction it is not thus ended. The railway company gets its engine, and the Belgian firm gets its money in the form of a bill of exchange on London. This bill has to be bought back, and it is bought back in the case we have taken as an illustration by the making and exportation of 10,000 pairs of Northampton boots, which would not otherwise have been ordered. This transaction is not ended until the railway company has got the engine, and the Northampton firm has got the railway company's money.

In both cases it ends by the railway company getting its engine, but in the first case the bill of exchange rests in the hands of the Glasgow firm, in the second case it ultimately rests in the hands of the Northampton firm who may be said to have purchased it by the export of their boots.

It is our purchase of the foreign engine which brings into the field of operations, so far as we are concerned, the foreign purchaser of our boots. If it deprives us of the expenditure of one capital and of one employment we might have kept in the country, it introduces into the country the expenditure of another equivalent capital and of another employment we should not otherwise have secured. There is no way of making the boots for Brussels and the engine for ourselves too. The British capital may be expended in Britain, or it may be exchanged for the expenditure of the Belgian capital in Britain, but we cannot have the expenditure of both capitals in Britain.

Fallacy No. 2.—The fallacy I have endeavoured to dissipate rests upon another which is at the root of the Protectionist's case, and is one which lends a superficial plausibility to his misinterpretation of the law and the condition of foreign trade in applying them to domestic trade. It lies in confusing two things which differ in kind, viz., the exchange of *two* simultaneously existing capitals in two countries, each for the product of an industry in the other country, with two successive exchanges of *one* capital in one country. The Protectionist is right in saying that the latter will give employment to two sets of labourers in one country, and the former to only one in each country. But he is wrong in making this comparison. Let me try to make this clear.

Every exchange of capital gives rise to a succession of exchanges, and a succession of employments—the bootmaker will employ the butcher, the butcher, with the money he has got from the bootmaker, will employ the baker, the baker the candlestick maker, and he the bootmaker again, and so on ad infinitum, so long as each by his industry maintains his production equal to his consumption and keeps his capital intact. It is possible for the bootmaker to imagine he is the spring of all the industry of the community, that his demand has set everything going; and in a sense and to a small degree he is. The railway company, which possesses the capital and orders the engine, will in the same manner set to work not merely directly the men who make the engine, but indirectly the men who do any work for the men who make the engine, and among them the bootmakers of Northampton, and they, in their turn, others. The Protectionist's error lies in confusing two such successive exchanges of one capital with a single exchange of two capitals. He will, and does, say, why should not Glasgow, *after* having received the draft for £3,000, proceed to ex-

change *that same capital* for Northampton boots? To ask this question is to fall into the error I am pointing out. He forgets that one capital cannot itself produce the capital for which it is itself exchanged. Two independent, co-existing capitals are involved in every exchange. We cannot trade with a tribe of naked savages who have nothing to give for our beads and knives, however much they may desire them. He is, I repeat, confusing the exchange of two independent, co-existing capitals with two successive exchanges of one capital. In this case we have the two co-existing capitals—that of the railway company demanding an engine, and that of the Brussels "emporium" demanding boots. At the point we have reached in the preceding section the transaction is completed, both demands have been satisfied, either by the double transaction which the admitted law governing international dealings demands, or by two single transactions, one in each country, which is all that ordinary internal commerce requires. In either case the railway company will have secured its engine, but in the one case the engineering firm at Glasgow will have in its possession a draft which, as the Protectionist says, it may expend upon boots; but in the other case the Northampton firm will equally have in its possession the draft which it may equally expend on an engine. Probably either party will put the money to pretty much the same use, and that will be the employment of British labour, and the production of more British goods. The Protectionist is right in saying that if the railway company expend their capital in Glasgow, this expenditure will result in further expenditure, some of it probably in Northampton. He is wrong in failing to see that if the two capitals are exchanged, a precisely similar set of employment would follow from the expenditure of the Brussels capital in Northampton. In making a comparison of a succession of employments let us keep step.

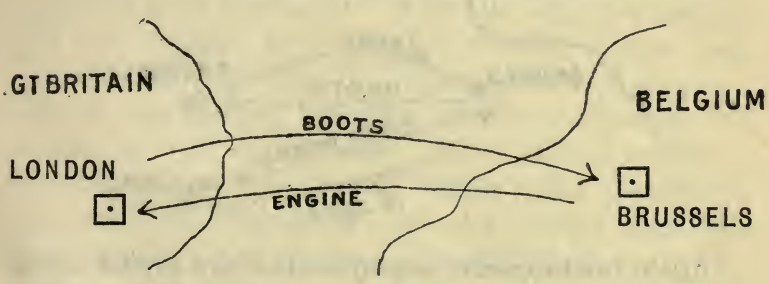
The real point to grasp and remember is that if the Glasgow firm has the money to use, the Northampton firm will not have it, and vice versâ.

The governing principle is that one capital cannot do the work of two equal capitals. It can only give a certain amount of employment. The capitals of the British railway company and the Brussels "emporium" may be exchanged; the employment these two capitals can give may be exchanged. In neither case can either by any magic be doubled. In one, by an exchange of capital and employments profitable to both countries, industry follows its natural and most efficient channels; in the other, all that has been achieved is not a creation, but a subsidised diversion of employment from the more efficient to the less efficient industry and a reduced net product for national distribution.

Recapitulation.

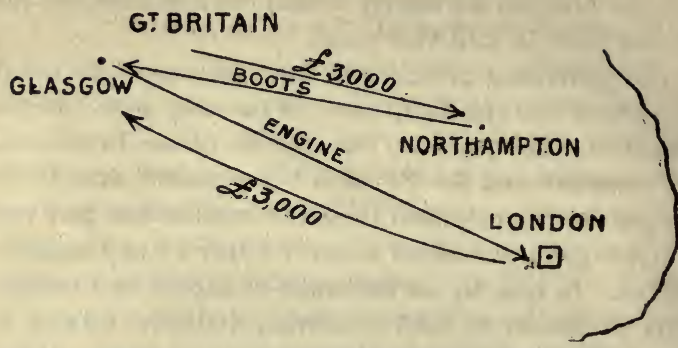
This argument, showing the two alternative exchanges and their first reactions, may be recapitulated in graphic form. The places, London and Brussels, possessing two capitals of £3,000, in which the demands originate are marked $\boxed{\cdot}$

No. 1. The Free Trader's first simple statement.



One equal exchange of two capitals and two employments.

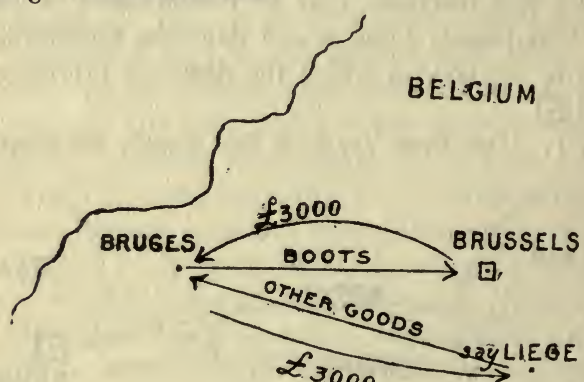
No. 2. The Protectionist's statement.



Two successive employments of one capital—first, London to purchase engine from Glasgow, and then, with the proceeds, Glasgow to buy boots from Northampton—both in this country.

The Protectionist forgets England has now missed the Brussels order, and in Belgium the situation would be thus:

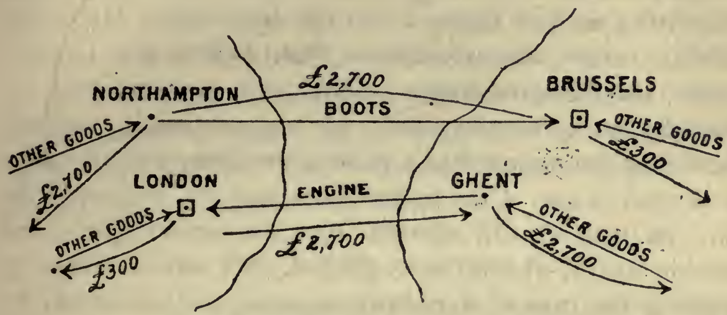
No. 3. With Protection.



Again two successive employments of one capital—first, to purchase boots from Bruges, and then, with the proceeds, Bruges to purchase other goods from, say, Liége.

No. 4. The full Free Trade statement.

The equivalent of 2 and 3 under Free Trade—that is, two successive employments of two capitals:



Showing that two successive employments have followed the expenditure of the Belgian capital in Northampton, just as it would have followed the expenditure of the British capital in Glasgow.

In these diagrams I have shown the original capitals brought into action as 3,000 golden sovereigns in the hands of the railway directors in London, and the same amount in the hands of the proprietors of the Brussels "emporium." I have shown the movement of these sovereigns as necessary to complete the exchange of two capitals in each transaction. And this expresses exactly what does happen, for though the metallic money does not move, the legal title to its possession and use does move in the manner indicated by the transmission of cheques or bills of exchange. Thus, after a complete analysis, we see that the Free Trader's first position is valid, and that the accepted axiom that foreign commerce is exchange is the conclusion of the whole matter, and the destruction of the whole case of the Protectionist that foreign imports diminish employment.

A Side Issue.

When the Tariff Reformer has been driven to admit the theoretical validity of this equation of capitals and employments, he usually takes refuge in illegitimately importing another element into the discussion. He immediately makes the assumption that, failing the London order, the Glasgow works would cease working, and the men be out of employment. He argues that it is surely better for the nation that a railway company should spend and even waste £300 rather than that an engine-works and its men should abstain from the production of an engine worth, at any rate, £2,700. He enforces this by putting the case of a railway company which owned its own engine-building works, and asks whether such a company would not keep its own works going, although the product might cost £300 more than it could import it for, rather than incur the much greater loss to both itself and its men of maintaining both works and men in idleness.

This is a simple example of begging the whole of the settled question over again. If the Glasgow men be thrown out of work, what about the Northampton men who are set to work? It may reasonably be argued that the engineers who declined to accept the obtainable price for their engine were at the moment in less need of work than the boot-makers who undercut the foreigner and secured the order.* As for the example of the railway company owning its own engine-works, if this example be extended so far as to assume that the company also owned the boot factory, there can be no doubt it would do well to acquire

* The only occasion on which, as Chairman of the Engineering Committee of the Board of a British Railway, I was tempted to place an order for locomotive engines abroad was in 1899, a time of such activity in trade that no good British maker would promise to begin to give delivery in less time than a year and nine months.

its engine in the cheapest market by employing its boot-makers rather than its mechanics.

Some plausibility, though no validity, is given to this argument by the likelihood that engineers would know they were thrown out of employment because their employers had missed an order which had gone to Belgium; while the boot-makers would probably not know or care to know that, but for the Brussels order, they would have been thrown out of employment, and still less would they know or care to know that they might have thrown out the Belgian boot-makers.

The National Profit.

In the foregoing argument I have endeavoured to prove that there is no loss of employment at home by our purchases abroad. I have not alluded to the profit of it. I have treated employment as an essential good to be desired for its own sake, and, if any equal quantity of it can be secured, I have treated the benefit of it as equal. But employment is not an essential good, it is a necessary evil. When a man says he wants work he really does not want anything of the kind. What he wants is wages, and he quite rightly wants the largest amount of wages for the smallest amount of work. The same is true of the nation in its foreign trade. Exports are its work, that portion of our imports which pays for them is our wages, and we want to get the largest quantity and best quality of these wages which come to us in the form of things we can eat or drink or wear, or use for our own production, in exchange for the smallest quantity of our exported work.

In the illustration we have been discussing, the engine, which at the moment it would have cost £3,000 to produce by Glasgow labour, was obtained all the same at the cost of £2,700 of Northampton labour, and the £300

which the railway company thus saved would be spent on the line or paid away in dividends, in either case providing employment up to the full £3,000, and the railway company and the nation would have £300 worth of something in addition to the engine to show for it. The same is true of Belgium, which obtains for her £2,700 engine the boots which it would have cost her £3,000 to make, and retains £300 for other expenditure on other employments. Both countries are £300 richer by the exchange. In each country the most efficient industry has received the due reward of its efficiency, and the less efficient industry has received a salutary stimulus in the form of successful foreign competition—a stimulus which to many British industries in the last few years has proved the one thing they needed to start them in a new career of enterprise and success.

Printed by Cassell and Company, Limited, La Belle Sauvage, London, E.C.

Cobden Club Publications.

Tariff Makers: Their Aims and Methods. A Sequel to Fact *v.* Fiction. Price **1s.**

Fallacies of Protection: Being Bastiat's "Sophismes Economiques," translated by Dr. Stirling, with an Introductory Note by the Rt. Hon. H. H. Asquith, M.P. Price **1s.** net.

Insular Free Trade, Theory and Experience. By Russell Rea, M.P. **6d.**

The Case against Protection. By E. Cozens Cooke. **3d.**

The "Scientific" Tariff: An Examination and Exposure. Price **3d.**

Cobden's Work and Opinions. By Lord Welby and Sir Louis Malet. Price **1d.**

Things Seen and Things Not Seen. Translated from the French of F. Bastiat. Price **1d.**

Shipping and Free Trade. By Russell Rea, M.P. Price **3d.**

The Lessons of History on Free Trade and Protection. By Sir Spencer Walpole. Price **2d.**

The Colonial Conference: The Cobden Club's Reply to the Preferential Proposals. Price **6d.**

What Colonial Preference Means. **3d.**

Free Trade. By Lord Avebury. **3d.**